U.S. RATE CUT IS HELPFUL BUT INSUFFICIENT

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The U.S.: Rate Cut at Last

Originally, it was predicted that the U.S. economy would grow 3.3% in 1998 and 2.6% in 1999, but a revision due to the emerging market crisis is inevitable. The recent global slowdown is almost certain to deepen in the coming months and persist into next year; we still believe that the U.S. and continental Europe are serving as the rare pillars of support for world economic growth. Economic activities in the U.S. seem likely to grow at a rate of 2.3% next year according to our latest revised estimates.

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Fortunately, American consumers' spending is still strong. The August U.S. personal income increased 0.5% compared with an increase of 0.4% in July, and personal consumption expenditures increased 0.6 percent. As a slowdown in corporate earnings due to the emerging markets' woes seems to be materializing, strong domestic demand in the U.S. and Western Europe are the only sources of effective demand in the world economy.

The Latin American crisis will threaten the soft landing of the U.S. economy, and the Fed seems to be worrying over the contagion effect of the rapid decline of U.S. exports to that region. If the U.S. government and the IMF decide to confer emergency support on Brazil, its vulnerable situation will stabilize much faster. Brazil will see a new president on October 4, which means that the current President Cardoso cannot take aggressive policy actions to boost the economy. Very high interest rates, a domestic credit crunch, and rapidly declining foreign reserves are the main hindrances to overcoming the current difficulties. Financial support from the U.S. will help console panicky foreign investors' sentiments. To block off a global contagion and to induce a soft landing phase of the U.S. domestic demand-led growth, U.S. support is indispensable.

In addition to the support, the Federal Reserve Board may decide to cut interest rates at the September 29 FOMC meeting. While Alan Greenspan was taking a stance of monetary tightening in July, he changed his position to be neutral last month. As global financial turmoil deepens, he is finally admitting the impact of the emerging market crisis, as seen in the near-failure of Long Term Capital Management (LTCM). However, we do not think the rate cut can give a strong boost to the global economy. As Hans Tietmeyer, the Bundesbank President, pointed out, monetary policy is not appropriate for resolving structural problems like tremendous bad debt. However, the rate cut will show that the Fed is determined to stimulate American industry investment, to buoy domestic demand and stock prices, and to block off the wave of the emerging market turmoil.

Japan: Bank Reform Only Way to Boost the Rest of Asia

The resolution of bad debt is most important current issue in Japan. The LDP and opposition parties agreed on the passing of "the Bank Reform Accord". But the Japanese banks are inter-linked through futures and options

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